

TRADERS

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The Delta Phenomenon

Humbug or Methodology? p. 10

Advanced GET

State-of-the-Art Software p. 28

Ichimoku-Charts

A New Perspective on Price p. 34



www.traders-mag.com

Nick McDonald

Trading – The Best Job on Earth p. 66



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TRADERS' Interview

Nick McDonald

Trading – The Best Job on Earth

Nick McDonald is the founder of Precision Trader through which he teaches & mentors people to trade for a living from home. Nick is an independent homebased trader himself and teaches others who wish to accomplish the same thing. He founded Precision Trader (www.tradewithprecision.com) to teach people 'real' trading strategies, omitting irrelevant information which is not conducive to trading success. Nick trades a variety of scalping, intra-day and swing trading strategies using technical analysis on both FX and on Dow Jones futures.

TRADERS': What did you think of trading/traders before you got involved?

Nick McDonald: I always had an interest in financial markets from an early age. I mostly read Warren Buffet type books on longer-term trading strategy. I thought that money was made through sound fundamental analysis and holding medium to long term and I knew next to nothing about technical analysis or charts. I thought that traders were stockbrokers and that is what I initially decided to become.

TRADERS': What enticed you to start trading?

Nick McDonald: I had a passion to work for myself while passionately hating all employment. Ever since my first job as a teenager I used to leave on the spur of the moment and deal with the consequences later. Somehow I always survived and taking a risk was something that did not concern me. I have never liked being told what to do – what time to start, what time to finish, how long to take for a break, what to wear, what to do, how to do it, etc.

I always had an interest in markets and also in business generally. I would read the financial section of the paper before the sports and loved talking about the markets. I read a lot on the subject and soon I was very competent and could talk 'investing' with anyone. The problem was I could not talk 'trading', I did not really know what it was yet even though I was buying and selling stocks and options.

It was a move back to London (from Auckland) and the people I met there that switched me from an investor mindset to a trader mindset. I passionately studied technical analysis, read charts and traded during every spare minute that I had. I must have come close to losing my job because I was checking market prices so often. I decided to get there first and I quit my job. Within three months of discovering technical trading I had left my job to trade for a living.

TRADERS': What do you think nowadays of Buffet's approach?

Nick McDonald: I don't think there is anybody out there who invests in financial markets who does not have a lot of respect and admiration for Warren Buffet. In addition to all he has achieved in his lifetime and his hard work ethic, the way he gave away such a large portion of his estate to charity recently is something I admire greatly and aspire to. As for his style of investing, it's not for me right now. I don't rule out having a longterm portfolio in the future but for now I am using intraday and swing trading as it is the best way I have found for income as well as wealth building.

TRADERS': Were you successful at the beginning?

Nick McDonald: When I was trading fundamentally and taking advice from others, no, I was not successful. During this time I was working for an investment bank and alongside a team of brokers. I talked about the markets all day and traded stocks and options, mostly on small cap oil and mining stocks. I lost money but not huge amounts. Looking back, I learnt a lot about the psychology of trading during this time. I jumped in and out of trades without a clear plan and often my initial idea proved correct after I had been scared out of the position.

After learning technical analysis and combining it with my knowledge to date, I was successful. Within 6 months of leaving fulltime employment I was comfortably making more than my previous salary. Since then I have never looked back.

TRADERS': So at this time your fundamental knowledge gave the direction of a trade and the technical analysis the timing? Is that still part of your trading now?

Nick McDonald: I use very little fundamental analysis now. However, having a fundamental background has given me the ability to understand the overall picture of the market fundamentals and economics a lot better, which still contributes towards my success. The small fundamental aspect of my current trading is listening to Bloomberg TV, printing out the economic calendar at the start of the week and avoiding technical trading during major economic announcements. The market is reacting to fundamentals at these times, not technicals, so I tend not to trade. I will, of course, trade the technical reaction to the news item but only after it has been released.

TRADERS': Did you commence trading with a small or large account size? (Of course, those terms are relative.)

Nick McDonald: I went out on a limb and left my job when I probably should not have. I could not really afford to live off my profits and only had a small account. I knew that I was never going to be anything other than a trader, so why go on working in a day job which I did not like? Somehow, I managed to get by during the early stages although it was tough. Less than two years later I had a twomonth period where I made more money than I would have previously made in 12 months. I realized then that I was no longer trading on a small account.

TRADERS': Many traders who start with small accounts are blown out of the market in a few weeks or months. You started with a very small account and trade full-time now. Do you think that's a feat that many traders can duplicate?

Nick McDonald: I think if you are determined enough to achieve something and burn all the bridges for the alternative then yes, you can find a way. Determination and persistence will usually get people there if it's what they truly desire. I left my job and did not ask for a reference letter, I deleted my CV from my files and ceremoniously destroyed all traces of it... I knew that that was the last job I was ever going to have. This is what I mean by burning the bridges. I did not leave myself an option of returning to fulltime employment.

TRADERS': What are some of the lessons you learnt while you traded with small money? In other words, what enabled you to survive this part of your career?

Nick McDonald: Money & risk management is crucial. I used to work on a system of very low risk but very high reward. My risk was usually 1% or less per trade on a small account. I stuck to this rule religiously so that I rarely lost more. I stood to make a lot more, however, when I got on the right side of a good trade. While of course I had many losing trades, most good trades would make around 3 to 4 times the amount lost on a loser and the odd trade made 10 or even 20 times and that was what really boosted the account. By having limited risk with unlimited reward, I managed to build my account to a stage where I could live off it. Also, after each profitable trade my account grew and so did the 1% that I could risk on the next trade. I now trade slightly more conservatively but the point remains the same, money & risk management combined with the discipline to stick to the rules are essential elements if you are first to survive and then succeed.

TRADERS': What kind of trader are you?

Nich McDonald: In my opinion there are 3 types of trader: scalping over minutes, intraday trading over hours and swing trading over days and weeks. Anything other than this I would consider investing. On Forex I trade intraday and if my longer- term charts line up with my short- term ones, then I will use my intraday entry as a swing position. To do this I only sell out of 80-90% of a trade at my intraday target and leave a small portion running as a swing trade. On Dow futures I do a lot of scalping which I don't do often on FX in addition to slightly longer intraday trades.

TRADERS': Do you think that the typical position size of an intraday trade should be considerably higher than for a swing trade? Is the remaining part of the position when leaving 80-90% of the intraday trade still the size of a normal position trade?

Nick McDonald: No to both. If anything, an intraday position will usually be smaller than a swing trade. However, I use my intraday positions to build into bigger swing positions. For example, if cable trended higher over a 12- month period, during that time I might have 50 intraday trades on it. If my intraday and long term views align then I will only close a portion of each intraday position. This builds a larger swing position over time rather than moving all in on one trade. The remainder is not the same size as a normal trade, rather it is 10-20% of it.

TRADERS': What are some of your market concepts or trading ideas?

Nick McDonald: The main concept is to always have as many reasons to enter a trade as possible. Many people trade divergence, others trade trends, some trade Fibonacci levels, others pivot points and others again trade clusters of support and resistance. The problem with this is that most traders are looking for these setups in isolation. It may sound complicated but I look for all of the above to be setting up precisely the way I like it at exactly the same time. Initially this could sound like a lot of information but once you understand all aspects of the trade then you can analyse all of the above in a matter of seconds and it is in fact very simple. It also results in only very high probability trades. I don't want a lot of trades. I want a lot of winning trades and am prepared to wait until the very best setups occur. This tends to happen approximately 5 -15 times per week in the FX market and 2-5 trades per day on the YM, mini Dow.

TRADERS': What is then the relation between your winning and your losing trades?

Nick McDonald: I aim to win on 75% of my trades with a minimum 1:1 reward- to- risk ratio. For example, if I risk £1,000 on a trade I will stand to make at least £1,000 or more if the trade hits my target. Of course, 1:1 is only the minimum. I prefer a higher reward- to- risk ratio and will always try to slant this at least slightly in my favour.

TRADERS': Are you a systematic trader?

Nick McDonald: I am approximately 85% mechanical and 15% discretionary. An element of discretion is almost always needed in my opinion. Sometimes my intuition says something slightly different to the mechanical trade setup and I have learnt to trust my intuition more than any mechanical rules. I have a few strategies which

are completely mechanical and I am currently setting these up to auto trade. This is a very small portion of my overall trading.

TRADERS': Where does discretion come in?

Nick McDonald: The best way I can describe it is from „Reminiscences of a Stock Operator“ by Edwin Lefevre. There is a part where Jesse Livermore has a very large position open and is not even watching the market. He got a hunch that he should close the position, so he did and he was right. Over time he grew to trust his hunches and tended to lose when he ignored them. This is what I consider intuition. As an experienced trader, there is often something happening in the market that consciously you are not fully aware of but unconsciously you are. While you can't quite put your finger on what it is, this unconscious thought often results in an intuitive 'hunch'. It is important that you record your hunches and gain a track record of them being correct or not before blindly following them. For new traders I encourage them to record their hunches but not to act upon them. Beginners do not yet have enough experience to act on intuition. By recording hunches and reviewing your records regularly you can discover over time which hunches are worth acting on and which are not.

TRADERS': Do you mix time frames?

Nick McDonald: Yes, I use different time frames for swing, intraday and scalping trades. Time frames range from one minute bars and tick charts for scalping to daily, weekly and monthly charts for swing trades.

TRADERS': Do you work more with indicators or with chart patterns?

Nick McDonald: There is no doubt that price action is by far the most important information on a chart. That is, the actual price movement on the candles. I also use indicators a lot but I only use leading indicators that predict price moves ahead of time rather than lagging indicators which only show a signal once the price has actually moved. Leading indicators include divergence, pivot points and Fibonacci. An MACD buy/sell signal when the two lines cross is taught in many textbooks and seminars. This is ineffective in my opinion since it is a lagging indicator and only gives a signal once the price has moved in a certain way. MACD divergence on the other hand is a leading indicator as it shows you in advance when a trend is weakening or likely to continue.

TRADERS': Does volume play a role in your trading approach?

Nick McDonald: It doesn't. With FX it is virtually irrelevant as there is just so much of it all the time. I trade the spot FX market a lot and as there is no definitive exchange then volume is hard to track and tends to be inaccurate. When trading other markets I do have volume on my chart but it does not play a big role in my approach.

TRADERS': Are you still looking for new set-ups?

Nick McDonald: No, not really. I do, however, know a lot of traders and when someone comes up with something that I like the sound of I will usually take a look at it. Often it results in me wishing I didn't. Most of the time it is not so much the strategy that will ensure success, it's finding the strategy to fit the person. I have found strategies that

suit me and that I know work so I see no reason to move my focus elsewhere right now but I keep an open mind.

TRADERS': Are you sure that your ideas will also work in a year or two? What happens when it comes to a structural break in market behaviour? Are you prepared for such a situation?

Nick McDonald: My strategies are always evolving and I tweak them as required. I also change markets occasionally depending on what is moving best at the time. I predominantly trade FX & E-mini futures but also trade Google almost daily and have had a lot of experience trading stocks. One benefit of teaching people is that those who go on to trade my strategies successfully often become good trading partners and their input and improvements help with the strategy evolution for keeping on top of conditions. Overall, I don't believe that market behaviour changes that significantly. The same technical analysis we look at now – candles, channels, triangles, pivots, Fibonacci – it has all been around for hundreds of years and in some cases longer. Economic conditions change but human behaviour remains the same and that is what causes most market movements.

TRADERS': How many different set-ups do you use for your trading?

Nick McDonald: For forex my main strategy is called the 'Precision FX Strategy'. I introduced this to Traders' Mag readers in an article called 'Trading FX with Precision', which was published in your FX edition of Traders Mag this year. I look for very strong trends across multiple timeframes and then enter on pullbacks of the trend, only in the direction of the trend, and only when the pullback is to a very strong cluster of support and resistance. This is my main setup and forms the basis of all my trading across all markets. Even when trading breakouts rather than pullbacks I still use the same principles. In addition to this, I have around 5-6 other strategies that I trade, mostly based on the same principles as the PFX strategy but with slight differences such as market, time frame, and target. The Dow, for example, has various other technical indicators which I use that are unavailable for FX.

TRADERS': How do you manage your risk?

Nick McDonald: I have a maximum risk of 2% exposed on the market at any one time. This may mean that I have one trade with 2% risk or four trades with 0.5%, the total risk is always capped. The great thing about FX is that this risk is determined and known in advance and then, due to the huge liquidity and the fact that FX is open 24 hours a day, there are virtually no gaps, which means you will almost certainly be stopped at your pre-determined levels. I used to trade stocks a lot but found that as a full-time trader with most of my wealth tied up in the markets it was too risky. Imagine that you have a business that manufactures some kind of goods and a warehouse stocked full of these goods. You arrive at the warehouse one day and find that the warehouse has been burnt to the ground and all your stock is destroyed. Now imagine that you have no insurance and it's gone for good. This was a risk that I was taking in the stock market, yet was not willing to take long term. The risk of a huge gap against my open positions, while low, was a very distinct possibility and there was no way to insure against this loss. This can be magnified by trading leveraged products and even while applying money management it

is possible to lose more than the capital invested. This risk is virtually eliminated by trading FX and not holding positions overnight on other markets.

TRADERS': How do you determine when you are wrong in a trade?

Nick McDonald: I am wrong if I don't trade exactly according to my plan. If I trade according to my plan then I do not differentiate between winners and losers, which I think is what you may be asking about. I know my entry, stop and target in advance, I know them all before the trade is even triggered. Hence, I lose money if my stop is hit and I make money if my limit is hit. However, a losing trade is not necessarily one that loses money. A losing trade is a trade that is not executed according to my trading rules. I know that if I execute precisely according to my plan I will make money over the long term and am hence winning. Even during non-profitable periods, I still consider myself to be winning provided I have not deviated from my plan. This is the only self-check that I make.

TRADERS': You mentioned a profit target. How is that determined?

Nick McDonald: I use reward-to-risk ratios, prior high or lows within the trend as well as Fibonacci extension levels to decide on targets.

TRADERS': Is money management an independent topic?

Nick McDonald: Risk management is a lot broader topic than money management. Money management refers to how much you place on any one trade, how many trades at any one time and how you will manage/spend the profits. Risk management refers to how many trades involving any one currency, how much you will allow yourself to make or lose in a day/week/month before stopping and how much of your total wealth you will risk in the markets.

TRADERS': What are your exact rules for that? You mentioned earlier that you never will have an exposure of more than 2%. Does that also influence the stop size? Or just the number of positions you trade simultaneously?

Nick McDonald: The only thing that remains constant is the percentage at risk. Some people talk in terms of number of pips but for me that is not a constant. If I risk 37 pips to make 37 pips, then I risk 1% to make 1%. If I risk 237 pips, the fact that I might make 237 pips does not matter, I still make 1%. So to answer your question, stop size is not influenced by the 2% rule but the number of positions traded simultaneously is.

TRADERS': What happens if you already have the maximum exposure and a new trade appears? Do you change your rules in such a case or do you close another position before entering the new trade?

Nick McDonald: When I am fully exposed I am not looking for new trades.

TRADERS': What was your worst drawdown?

Nick McDonald: I once lost 14% in a day while trading stocks due to no fault of my own. It was a big gap and it was intraday, i.e. not even between close and open but in the middle of market hours. There was no news and no apparent reason for it – it was just a freak occurrence. It got me thinking a lot more about this risk of trading

stocks though. Hence now I only trade FX, mini-Dow and other highly liquid markets.

TRADERS': When did you realise that trading wasn't going to be a just an attempt in the markets, but was going to be a full-time career for you? Or did you sense that from the beginning?

Nick McDonald: From my first introductions to technical analysis I knew I had found exactly what I wanted. When I left my job to trade full-time there was no turning back.

TRADERS': Where does the psychological element come into play?

Nick McDonald: I consider psychology to be around 75% of the trading game and only 25% of it really comes down to strategy & fundamentals. Even though an actual strategy could be 85% to 100% technical, without the right trader mindset very few traders will make those technical rules work. Unfortunately, so many new traders fail to recognise how important psychology is and I put this down to why many new traders fail. You have to constantly strive to be trading at your best and that takes a disciplined mind. You must be focused, consistent, selective, disciplined, intuitive, open-minded and in full control – all at the same time. None of the above can be classified under strategy, it's all about the trader mindset.

TRADERS': Unfortunately new traders are not aware of that. Do you have any kind of advice to overcome that problem? Especially for beginners?

Nick McDonald: Stop looking for the Holy Grail. Strategy is important and you do have to find something suited to your personality that works but that is a minor part of it. Virtually no strategy will work if you cannot recognise and master your emotions. The Holy Grail hunters learn something new, get excited, place a few losing trades, get disheartened and then move on to the next strategy. This cycle often continues indefinitely. What they are not realising is that strategy is rarely the problem, it's the individual. Some of these strategies probably would work given time and effort. People will do things such as take profits too soon, manage money badly due to fear of losing too much or due to greed of trying to make more than they should. They will trail stops or take profits too quickly for fear of giving back profits, they enter too early concerned with missing the entry completely. All of this is incorrect behaviour and is due to the individual's emotions getting in the way of their strategy. Many new traders will scoff at these comments, yet when someone shrugs off the importance of psychology I usually get a fairly good idea of where they are at with their trading. Struggling! I teach people solid trading strategies, highlight the trader mindset required to complete the strategy effectively and provide ongoing mentoring support to ensure traders stay focused on what truly matters. Most mentoring tends to work on similar ratios to trading, 75% of the mentoring is on trader mindset and only a small part is technical.

TRADERS': Any words about fear, greed and self-esteem?

Nick McDonald: Fear and greed are dangerous frames of mind to be in, not just for traders but for everyone. The problem is that many traders don't recognize that they are being fearful or greedy and therefore don't do anything to rectify it. Recognition and rectification

of these factors through psychological training and constantly striving to be on top of your game is the ultimate solution.

TRADERS': What do think is the difference between you and so many other traders who were kicked out of the game?

Nick McDonald: Most people don't want it badly enough. They may think they do but if they don't make it then they probably didn't really want it as much as they thought and gave up too soon. I don't think I have met a person whose life goal was to become a trader who has not eventually made it. By that I mean those who REALLY want it above all other career moves will get there eventually. Persistence and determination are the keys. If someone wants something that badly then whether it takes weeks, months or years, they will keep on going until they get there. The average person will stop at the first hurdle, after the first failure or rough patch in the market. We all face those patches, every single trader does. Therefore, to answer your question in a nutshell – the winners will never give up, the losers give up at early signs of failure. If as a kid when you fell off your bike, you never got back on it then you would never learn to ride the bike properly. You must learn from your mistakes and get back on the bike to give it another go. Starting to trade again after a period of losses and learning from it, makes a trader stronger. As with riding a bike, making mistakes is the only way to learn. People are often focusing on a dream of making millions in the markets rather than the reality of hard work, discipline and persistence required to achieve success. If you come to the market prepared to work hard then there is light at the end of the tunnel and fun to be had along the way!

TRADERS': So when you're not trading, how do you enjoy your free time?

Nick McDonald: My trading strategies are very well defined, so are not too time-consuming. I can't go without social interaction and that is often missing for home traders like me if we don't have other hobbies. For this reason I started Precision Trader and now spend a lot of my spare time mentoring other traders and growing the company. I enjoy the challenge of business as a break from trading and with trading being my passion, a trading business is a perfect solution. I also consider relaxation very important, so spend a lot of time out walking as well as at the gym. When I am not doing any of the above I am usually out lunching with friends or at my computer listening to music with one eye on the markets and the other surfing the net or working on a new project. I have lots of projects going on at the moment.

You can learn more about Nick McDonald and Precision Trader at www.tradewithprecision.com.

Nick wrote a couple of articles for our last TRADERS' extra about Forex trading. If you would like to read them please write an email to forex@traders-mag.com and we will send you the articles free of charge.